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Economic Conditions
Governmental Finance
United States Securities

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General Business Conditions

THE closing month of 1931 has brought little change in the character of the trade news, and the problems that have been to the fore have been such as to make it another period of anxiety and strain for American business men. The public mind has been occupied with the difficulties of the railways and of Germany, among other consequences of the depression; and the fall in prices of bonds, stocks and commodities to new low levels during the month was decidedly depressing, coming as it did after a turn for the better in the first half of November had aroused hopes that the way to recovery was opening up.

To its credit the country has met the strain of this trying period with composure. There has been no such epidemic fear for the safety of bank deposits as appeared in the early days of October, and no such clamor for currency. The number of bank failures for the month will be very large but will not approach the October record of 522, the total in three weeks ended December 25 having been 227, according to the American Banker's compilation. The increase in currency in circulation is accounted for by withdrawals for Christmas expenditures.

It is undoubtedly more than a coincidence that in both 1930 and 1931 the low point in the general business situation and in the markets was reached toward the end of the year. In basic industry December is always a slow month, with shutdowns common for holiday and inventory purposes, and the trade figures are seldom of a stimulating nature. In a depression year it is likewise a month of selling goods to reduce inventories, and of selling securities and commodities to establish losses.

Of all markets the decline in bonds has been most severe. Amid the confusion of the times those who could buy bonds have been plainly uncertain as to what debts are good and what are not, in view of the difficulties present conditions hold for debtors, and have abstained from the market with disastrous effect upon prices. This continues to make new financing and even refinancing virtually impossible. It has a paralyzing effect upon business revival, since the projects that would bring about revival obviously cannot be undertaken until they can be financed.

Psychological Features of the Situation

The American business man has been trained in a school of optimism, but for more than two years has been contending against a decline in activity and in price levels in all markets, and after that long period finds that conclusive evidence of the turn is still lacking, and that problems of indisputable gravity remain to be dealt with. It is not to be wondered that feelings of depression or bewilderment have affected many, with the result that caution has been put ahead of enterprise, safety above risk, and all the problems raised that come from the "frozen confidence" of which President Hoover has spoken.

To counter these alarms President Hoover has recommended a program for economic recovery centering on those problems upon which general attention has become fixed, and which accordingly supply the keys to the situation. The principal feature of the program is the creation of a Reconstruction Finance Corporation to furnish necessary credit otherwise unobtainable under existing conditions, and to protect against "further paralyzing influences and shocks." A bill for the establishment of this Corporation has been promptly introduced into Congress, and its passage in January is predicted. It will give support, among others, to the railway situation, which through its effect on the bond market constituted in December a national emergency; and it appears likely that early in the new year the plight of the railways will be relieved in a threefold manner: through rate increases already authorized, the proceeds to be loaned to the weak roads, through wage reductions, and through loans by the proposed Corporation to roads having maturing debts to meet which it is not practicable to refund in the present bond market. It is certain that nothing could

be more helpful in the domestic situation than measures enabling the railroads to overcome their temporary difficulties.

The purpose of the Reconstruction Finance Corporation is to bolster private credit by a movable pool of public credit, in order to preserve the liquidity of solvent institutions and to prevent the loss and demoralization that would result from unnecessary foreclosures forced by temporary conditions. There is room for dispute as to the limits within which the Corporation should function, but the general proposition is one suitable to the emergency. Technical argument as to the inflation that may be involved, in case part of the Corporation's funds come in last analysis from the Reserve Banks, seems beside the point. The situation is that going concerns, very important in the business activities of the country, need more credit than it is practicable to obtain through the usual channels under present conditions.

A necessary qualification is that the ability to borrow should relieve no one from the need of reducing costs and making the other readjustments required by the depression. Wage reductions that will help the railroads to balance their outgo and income are as necessary in this reconstruction program as loans to them. We could not view with complacency efforts to stimulate building, for example, through expansion of credit unless they should be accompanied by continuing reduction in building costs.

Proposals for General Inflation

It is said by all observers, and apparent in the action of the bond market, that a chief cause of psychological depression is the belief that the decline in the general price level has added so heavily to the burden of debts that they cannot be paid, that the effort to pay them will keep the country drained of current purchasing power, and that defaults and compositions will cause losses and disturb business for a long period to come. More likely, if the sequence could be untangled, this belief would be found an effect rather than a cause of discouragement; but in either case the state of mind described is a serious one and is responsible for raising the question whether, as the phrase is, "inflation is the only way out." The proposition is that the general commodity price level must be raised to escape the conditions just stated.

With the general proposition that a recovery in prices is of vital importance there will be little dispute. The only difference of opinion will be as to how this can be brought about. We do not quarrel with the contention that the deflation of credit has become excessive, and we should be glad to see on the part of the banks a greater ability to extend credit and on the part of solvent borrowers a greater willingness to use credit. Some way needs to be found to increase the amount of credit in circulation. We believe, however, that this can best be done by supplying relief for emergency situations, such as is contemplated in the formation of the Reconstruction Corporation, thereby stimulating confidence and creating both a greater courage on the part of the borrower to use credit, and, through the return flow of hoarded currency to the banks, a greater eagerness on the part of the banker to find investment for his increasing deposits. In this way, the pressure of forced liquidation would be lessened, covering of future wants encouraged, and prices stimulated. Such a program depends for its effectiveness upon striking at the root of the present difficulty, which is fear, while at the same time it avoids the dangers of unrestrained inflation which lurk in many of the popular plans for bolstering up the price level, such as printing more money or issuing huge amounts of Government bonds to finance unneeded public works.

The burden of indebtedness of which so much is made has had its equivalent in every depression, but it has never prevented recovery. It will be dealt with in three ways. It will be paid off, as it already has been at a great rate. It will be reduced by arrangement between creditors and debtors. Finally it will be lightened by the progress of recovery. There is no reason to believe that final readjustments will leave food and raw material prices in the depths while bringing prices of manufactured goods closer to them. They will more likely restore the balance by raising the former as the latter are reduced. Many times in our economic history the fear has been expressed that prices would never recover again, but the fact is that they always have.

The Standard of Value

The action of Japan in leaving the gold standard seems to have started another wave of gossip and verbal speculation as to the possibility of a general movement, including the principal countries and even the United States. There is so much confusion on the subject that it is well to consider carefully the conditions which have induced the action of the countries that have left the gold standard, whether the conditions exist in other countries named, and what the effects upon general prosperity would be if all countries should abandon the idea of having a common standard of value.

In the cases not only of Great Britain and Japan but the other countries that have thus far followed the same course, the action was involuntary; they have not left the gold standard from choice but because circumstances

which they considered to be beyond their control compelled them to suspend gold payments. The balance of payments on their settlements with the rest of the world was continuously against them in such volume that they were losing their gold reserves, the basis of bank credit, thus making necessary a contraction of credit, with depressing effects upon business and prices. Apparently they were in the way of losing all their gold and accepted what seemed to be the inevitable.

The United States is not one of the countries which has been compelled to contract credits as a result of losing gold reserves. On the contrary this country has surplus reserves sufficient to provide for a normal expansion of credit for many years. The contraction of credit and decline of prices in this country since 1929 has not been due to incapacity for credit expansion, but to a disastrous reaction from an excessive use of credit in previous years.

The theory that a country strengthens its competitive position by depreciating its own money is deceptive and unsound. All can remember the outcry against German competition in the years following the war, when its currency was depreciating, but Germany did not gain prosperity by that means. The chief claim of benefit to Great Britain from leaving the gold standard has been that wages would be indirectly lowered and British export business thereby placed in a more favorable position. The country gained a temporary stimulus to exports by offering the same goods at the same nominal prices in a cheaper money, but in the long run this must lead to higher internal prices and higher wages, or real wages will be lowered. As regards both wages and competitive position the change settles nothing. Only a new and most demoralizing competition is introduced by manipulating the money.

With all countries holding their currencies firmly to the gold standard, prices in all countries had definite relations to each other. If all countries should leave the gold standard and use paper currencies having no fixed relations to each other, international trade would be in a state of chaos; and domestic trade would be in almost as great confusion. In truth the situation would be intolerable.

Many of the persons who seem readily disposed to try the experiment of cutting loose from the gold standard for a little flyer in inflation apparently have no conception of the confusion and disaster which might result. They know the terrible experience of Europe with inflation following the war, but doubt that anything like that could happen to the United States. The fluctuations of the British currency since it left the gold standard are not reassuring. The value of the pound sterling in exchange for United States dollars in September was $4.86, but has since been as low as $3.25½, a decline of approximately one-third. Last month the range of fluctuations was between $3.25½ and $3.45. The effects of such fluctuations in the value of a country's money cannot be other than harmful. It is true that a depreciating currency makes for rising prices, but if a currency depreciates constantly it becomes worthless, and if it constantly fluctuates up and down it makes all business a gamble. Whatever monetary reforms may be proposed, the world should not abandon the principle of a common standard of value.

All countries want the price level raised, but common sense dictates that a higher price level would be a poor swap for chaos in monetary systems and therefore in all business. It is strange that so soon after the great lesson upon the evils of inflation taught by the war and post-war conditions in Europe, to say nothing of the conditions preceding this depression, so many people should be blind to them. Inflation is never a way out; it is only a way in.

No Less Work To Be Done

Among current fallacies contributing to a pessimistic psychology, the belief that the world is slowing down and that there will be less work to be done hereafter is important. If the lessons of history, and of all the examinations conducted into the characteristics of the human being, teach anything to this generation it is the falsity of this ancient idea.

It is often said that recovery from the depression of the '70s was accomplished by the railway-building of the '80s; that recovery after the '90s followed expansion of gold production in the Rand and Alaska; and that the revival after 1921-22 was accounted for by filling up the deficit in housing construction, by making up war shortages generally, and by the rapid growth of the automobile industry, supplying a new want. The implication is that business has been pulled out of each depression by some special circumstance, and that otherwise it could not have recovered. The contrast is set up that there is now no deficit in construction to make up; that the automobile industry has saturated its market in this country, and that no new industry is in sight to replace it. To cap the charge, the declining rate of gain of the population is declared to evidence a general slowing down of business growth for which everyone should prepare.

All students of the statistics are agreed that the rate of population increase is slowing down. In the last Census period 17,000,000 were added to the population, but the expecta-

tion now is that the next increase of this amount will require three decades, or until 1960. On the basis of these estimates pamphlets have been written pointing out the business difficulties entailed.

The error in the argument is that while there may be a limit to population growth there is no limit to the growth of human wants. It is a safe proposition that wants never cease to expand. Families in four-room apartments would like to move into six-room apartments, and those in six-rooms would like to have eight rooms, with all the additional furnishings and an automobile in the garage. City dwellers want country houses, however modest, for summer use. None of these wants is near satisfaction.

Future Opportunities

There are pessimistic prophecies concerning the construction outlook in this country. Some say the country is "all built up." Of course there is enough housing and office and factory space to meet the diminished requirements of depression. But it is safe to say that the housing industry, in the longer view, is still in its infancy. New materials and new methods of using old materials are being developed. At the President's Conference on Home Building last month the Committee on Technological Development reported that "the small house in the future will not resemble any of the houses of the past. It will cost one-half as much and be far more efficient." This foretells the coming reconstruction and modernization of the country's housing, so that it will no longer be true, as the Conference was also told, that families with incomes below $1,500 cannot afford new houses representing adequate standards of living.

A similar situation exists in factory equipment. Machinery is growing obsolete and will continue to grow obsolete, as long as technical progress continues and perfects new machines which will save enough in cost of operation to pay for themselves. The American Machinist considers ten years the average life of machinery before obsolescence, and calculated in 1930 that 48 per cent of all in use was more than ten years old. The demand of the times for cost reduction will speed the re-equipment of the industries when capital is again available. It can be said that at present there is no dearth of potential borrowers, who are ready to carry out projects when they can finance them. The lack is of lenders.

In every depression unsatisfied wants accumulate. The number of passenger automobiles in use has declined this year by about 4 per cent, but all of those who have given up their cars want them back, and the number of unused miles of transportation left in car owners' hands is estimated to be 17 per cent less than at the end of 1930. In St. Louis a recent survey, revealing conditions that are probably typical of many cities, showed that doubling up in living quarters had resulted in two and one-half times as many extra families living in single houses as there are vacant houses.

These citations could be extended, but they will make the point. The difficulty is not shortage of wants, but lack of the equilibrium which would permit the flow of satisfactions from one person to another on an equitable basis of exchange. Costs are too high and incomes too low only because the basis of exchange is disrupted. There is no cause for despair in this, but only for resolution in attacking the problem.

Along with the old industries, new ones constantly appear and grow. No electrical engineer or chemist, familiar with the progress that science is making, will ever subscribe to the idea that there is less work to be done. In modern times wants are ascertained by investigation and inventions made to order to satisfy them. Industries now only on the threshold of development include aviation, refrigeration and air conditioning, television, and the electrical and chemical industries generally. An official of the General Electric Company stated in 1929 that one-fourth of its total production was made up of new lines developed since the war.

It is said that agriculture must suffer from the effects of decelerated growth of population and food needs. Undoubtedly readjustments will be required. But to the research chemist agricultural products are already more than food or simple raw materials. Cotton is not only cotton, but cellulose, and corn is a rich repository of chemical elements.

Mistaken Prophecies of the Past

We have said that the belief that there is less work to be done is an ancient one. In 1844 the then United States Commissioner of Patents, Henry L. Ellsworth, "contemplating the astounding advances made in the mechanical arts during his lifetime and incumbency of office, and fearing a cessation of all endeavors in the field of invention, apprehensively said: 'The advancement of the arts, from year to year, taxes our credulity and seems to presage the arrival of that period when human improvement must end.'" (Journal of the Patent Office Society, September, 1919.)

Of course, Mr. Ellsworth did not live long enough to ride in any vehicle common today, to speak through a telephone or to read by electric light a newspaper printed from type set by machine; but even as he wrote Goodyear was vulcanizing rubber and Elias Howe perfecting his sewing machine.

The first comprehensive study of business depressions was made by the first Commissioner of Labor, the Hon. Carroll D. Wright, an economist of repute, whose report published in 1886 is a very valuable one. In the course of his report Mr. Wright said, the bold type being ours:

Industry has been enormously developed, cities have been transformed, distances covered, and a new set of economic tools has been given in profusion to rich countries, and in a more reasonable amount to poorer ones. What is strictly necessary has been done oftentimes to superfluity. This full supply of economic tools to meet the wants of nearly all branches of commerce and industry is the most important factor in the present industrial depression. It is true that the discovery of new processes of manufacture will undoubtedly continue, and this will act as an ameliorating influence, but it will not leave room for a marked extension, such as has been witnessed during the last fifty years, or afford a remunerative employment of the vast amount of capital which has been created during that period. * * * **The day of large profits is probably past. There may be room for further intensive, but not extensive, development of industry in the present area of civilization.** * * * Supplying themselves with full facilities for industry and commerce will give to each of the great nations of Europe and America something to do, but the part of each in this work will be **small and far from enough to insure more than temporary activity.**

This outgiving was the fruit of long study. Yet nothing is clearer than that the man of 1886 would not recognize the world today, only forty-five years later, and the tools creating change and progress are incomparably more numerous and effective than they were then.

In his book, Evolution In Science and Religion, Dr. Robert A. Millikan, the famous physicist, describes a point of view which he says was undoubtedly held by most of the outstanding scientists in the early '90s. Commenting upon a lecture, he writes:

Then, summarizing this wonderfully complete, well-verified, and apparently all inclusive set of laws and principles into which it seemed that all physical phenomena must forever fit, the speaker concluded that it was probable that all the great discoveries in physics had already been made and that future progress was to be looked for, not in bringing to light qualitatively new phenomena, but rather in making more exact quantitative measurements upon old phenomena.

Just a little more than one year later, and before I had ceased pondering over the aforementioned lecture, I was present in Berlin on Christmas Eve, 1895, when Prof. Roentgen presented to the German Physical Society his first X-ray photographs. * * * As I listened and as the world listened, we all began to see that the nineteenth century physicists had taken themselves too seriously, that we had not come quite as near sounding the depths of the universe, even in the matter of fundamental physical principles, as we thought we had.

Of course, all concepts of the nature of matter have been revolutionized since the demonstration of the X-ray, the assault upon the atom has gone on unceasingly, and no one yet knows what the great series of discoveries that have been made will mean in industry and daily life.

The claim that the world is slowing down, and that there is nothing to pull it out of this depression, is plainly a short-sighted one. It is unsupported by precedent or probabilities, but is dangerous in that it obscures the true nature of the depression and of the revival that will come, and contributes to an unwarranted pessimism which complicates the problems of readjustment. It would be a misfortune if these misapprehensions should lead to mistaken policies which to relieve people in one place would permanently arrest readjustments in another, temporarily cover up the lack of equilibrium, and administer to business not a remedy but an anaesthetic. The counsel of inflation is a counsel of despair, but the counsel of readjustment is one of hope and resolution.

Money and Banking

The money market during December has been under the influence of the usual seasonal factors. On and around December 15 the shifting of funds incident to Government tax day operations was also a market influence, making money alternately easy and firm as excess funds disbursed by the Treasury on the 15th were gradually absorbed by the collection of income taxes and withdrawals of Government deposits from the banks to extinguish temporary Treasury borrowings from the Reserve banks.

An increase of $222,000,000 in currency in circulation during the first three weeks of December was the principal cause of firmness, bringing total currency outstanding on December 23 to a new peak of $5,733,000,000. This increase is in accordance with the normal holiday currency requirements, and is not to be interpreted as evidence of increased hoarding. Nevertheless, the necessity for paying out currency regardless of the purpose has tended to increase the difficulties of many banks not favorably situated as to liquid assets, and doubtless has been a factor in increasing the number of bank failures. Hence it is encouraging to consider that from now on until the end of January, barring an extension of hoarding, the seasonal trend of currency requirements will be sharply downward, which should materially ease the banking position.

Reflecting the foregoing influences, the trend of money rates has been somewhat firmer during December. Call money rose from 2½ to 3 per cent during the latter part of the month, and stock market time money rates were also a shade firmer. Other rates, however, were unchanged.

That money rates did not rise more sharply under the influence of increased demands was due to a number of counter-balancing influences. Monetary gold stocks increased $56,000,000 during the four weeks ended December 23, largely on shipments from Japan, while

a decline in foreign deposits at the Reserve banks, coupled with an increase in contingent liability of Reserve banks on bills bought for foreign correspondents, indicated additional foreign participation in our bill market, thus increasing the supply of funds as well as reflecting enlarged confidence in the dollar on the part of important foreign interests. At the same time, a scattering of small shipments of gold coin to various European countries was evidence of continued small unit hoarding of gold abroad. Such demands are reflected here because, contrary to the practice of most central banks, our Federal Reserve Banks pay out gold in small allotments.

Reserve Bank Operations

Besides the gain in gold and the payment into the market of foreign funds heretofore held idle at the Reserve bank, an increase of $126,000,000 in Federal Reserve Bank credit in the two weeks before Christmas was also a factor in the situation. Of this increase, all and more was in the form of rediscounts, which expanded $186,000,000 as against an increase of $41,000,000 in holdings of Government securities and a decrease of $132,000,000 in holdings of bills purchased. At $911,000,000 on December 23, the volume of rediscounts was the highest since 1929, although the total volume of Reserve bank credit outstanding was $232,000,000 less than in October when the export gold movement was at its height.

This heavy volume of rediscounting, centered mainly in the interior, continues the most unsatisfactory feature of the credit situation, since, by imposing pressure on the banks, its effect is to further extend the already drastic liquidation of member bank loans and deposits. The fact that so large a proportion of the member bank borrowing is located outside of New York and Chicago makes it difficult for the Reserve banks to extend relief by open market operations, since such operations are of necessity confined to the larger money centers.

The Decline in Bank Credit

The decline in the volume of bank credit has continued during December, reducing total loans and investments and total deposits of the weekly reporting member banks to new low levels since 1927. In the twelve weeks since the end of September these banks have reported a shrinkage in deposits amounting to $2,315,000,000 or 11 per cent, indicating what is probably the most drastic decline in bank credit that the country has ever experienced in a like period.

The cause of this extraordinary decline lies partly in the dullness of business and the prevailing pessimism of the time, which has resulted in a scarcity of prime credits, and partly in the pressure that exists upon banks in many localities, both because of withdrawals by depositors and the inability to realize promptly on banking assets. As a result of this pressure, bankers generally have been forced to give prime consideration to their liquidity, with the consequence that credit in the aggregate has been reduced, and the difficulties against which business has been contending thereby intensified.

The Bond Market

We have already referred to the drastic decline in bond prices during December, and the reasons for the state of mind which caused the demoralization of the market in the middle of the month. For a short period there was for many issues practically no market at all, with the result that sales in amounts normally insignificant caused severe breaks. On the 18th, however, a sharp rally signalled the return of a more orderly market.

Individual liquidation has been going on, but important selling has come from the banks. On December 23 the reporting member banks' holdings of securities other than United States governments had declined for thirteen consecutive weeks, the drop being $286,000,000, and their holdings of governments declined $226,000,000 in the ten weeks ending December 9, following which an increase occurred in consequence of their subscription to the offerings of December 15.

Bond purchases by the life insurance companies have necessarily been smaller. One factor in reducing them has been the rise of loans to policyholders. These loans in other years have constituted around one-eighth of insurance company assets, but at a recent hearing in Washington, Mr. Frederick H. Ecker, President of the Metropolitan Life Insurance Company, gave evidence that 32 per cent of all investments of his company in 1931 had been in the form of policy loans.

While the prime cause of bond weakness has been the general fear that debtors cannot maintain their ability to pay throughout the depression, the market has been concerned about special conditions in several groups. Among these the railway situation, described hereafter in this Letter, has been outstanding, and in both decline and rally rail bonds led the market. One step, the rate increase, in the program of support for the railways has already been taken; and wage reductions and government loans to meet maturing issues are expected to follow. Numbers of rail bonds, and other bonds likewise, on which interest this year has been earned with a margin over, have been selling at receivership prices, the decline in the market having equalled or exceeded any probable loss that the security might sustain in event of reorganization. Such

prices are clearly at variance with the progress made in dealing with railway difficulties, and it is among these groups, and among other corporate bonds on the corresponding level, that bargain hunters have begun to look.

Government Bond Decline

United States Government bonds have been consistently weak, and have dropped to new low prices, in most instances selling to yield more than 4 per cent. On December 15 the government did its quarterly financing, and in view of the market situation limited its offerings to maturities of six months, nine months and a year, which bore coupons of 2¾, 3 and 3¼ per cent, respectively. The total offered was $1,300,000,000, which was $210,000,000 in excess of maturities and interest obligations due on that date, continuing the "deficit financing" which has been the chief cause of the drastic decline in prices. The municipal division of the market likewise has been weak. Concern as to the fiscal condition of some municipalities is apparent, affecting the prices of all bonds.

These declines in government bonds supply conclusive answer to the argument for government expenditures, Federal or local, for the purpose of stimulating business. The fact is that they increase the strain upon the banking system, the insurance companies, and business generally, and defer recovery by deferring the reestablishment of a bond market that will be accessible to private borrowers.

New security issues during the month have continued very small, and have been almost entirely short term. The chief item in the total of $106,000,000, through the 26th, was $60,000,000 of New York City 5½ per cent notes running only three, four and six months. The rate contrasts with 1⅜ per cent on a three months' loan as recently as September 24.

New security issues in 1931 (excluding U. S. Governments) have totalled almost exactly $4,000,000,000, the lowest since the Chronicle began to compile its figures in 1919, and comparing with $7,300,000,000 last year. The total of corporate security issues, including those for refunding purposes, has been approximately $2,200,000,000. In the same time $1,700,000,000 of corporate bonds have been retired through maturity or through call in advance of maturity, according to the Dow-Jones compilations. Thus the net new capital raised in the market for corporate purposes has not exceeded $500,000,000, and this calculation does not allow for retirements through purchase by corporations of their own bonds at a discount in the open market. This is very much the smallest figure in many years, the average net investment in the five years preceding 1931 having been around $2,250,000,000 annually.

There seems hardly room for doubt that there will be a scarcity of seasoned corporate bonds when the market returns to normal, though in government bonds the supply of course is being added to during this period.

Outlook for the Railroads

The railroad problem has ceased to be merely a railroad problem, and is a general economic and financial problem of the first magnitude. The savings of the American people are invested, directly and indirectly through their bank deposits and insurance policies, to a greater extent in railway securities than in any other class except those of the United States Government.

More than 70 per cent of all railroad bonds and notes are held by banking, insurance and other institutions. Of the $10,703,000,000 total outstanding on December 31, 1930, life insurance companies alone held approximately $3,000,000,000 or 28 per cent as part of the assets protecting their 50,000,000 policyholders; mutual savings banks, with 13,000,000 depositors, held $1,700,000,000; member banks of the Federal Reserve System owned $987,000,000 according to their September 29, 1931 statement and the holdings of non-member banks are estimated at $300,000,000; in addition to the above, the holdings of banks and trust companies in a fiduciary capacity, fire and casualty insurance companies, universities, hospitals, religious and charitable organizations are known to be well in excess of $1,500,000,000.

In 1931 the prices of railroad bonds experienced a universal decline, extending from a few points to 25 or 50 points in the case of the weaker issues, and the resulting depreciation in many cases wiped out surplus account and even impaired the capital of institutional holders. The railroad situation has now drifted to a point where the sacrifice of capital or of labor is no longer the chief issue and the solvency of the entire economic structure is at stake.

The Problem and Proposed Remedies

The severe decline in the volume of railroad traffic and revenues last year, combined with the relatively fixed level of expenses for operations, maintenance, bond interest and taxes, reduced the net income of most individual companies to the vanishing point and in many cases resulted in actual deficits. A general downward revision or complete omission of dividends has been necessary, while railroad bonds have declined heavily and prices of common and preferred shares have virtually collapsed. Three important railroads, the Wabash, Ann Arbor and the Florida East Coast, have been forced into receivership, and the Seaboard Air Line went into receivership in December, 1930.

In June the railroads made a petition to the Interstate Commerce Commission asking for a temporary increase of 15 per cent in freight rates, which was denied on the grounds that a general rise of this amount during a period of depression would impose undue hardship upon shippers and divert traffic away from the railroads. The Commission proposed, however, a schedule of increases on specified commodities with the provision that increased revenue from this source might be made available to the roads not earning their fixed charges.

To this proposal the railroads submitted a counter plan for treating the funds turned over to the weaker roads out of increased rates as loans instead of gifts. The Commission accepted the modified plan, and the railroads have organized the Railroad Credit Corporation through which the loans will be handled. It is expected that the new rates will increase gross revenues by around $100,000,000 annually, although this of course will largely depend on the volume of traffic, while the amount of bond interest not being fully earned has been estimated at around $75,000,000.

The plan makes no provision for meeting maturing obligations, and for this purpose a participation in the Government's Reconstruction Finance Corporation is being considered by Congress, to be loaned by the Treasury to such individual railroads as are temporarily unable to sell securities to refund maturing issues. A similar fund was appropriated in 1920, from which loans of approximately $351,000,000 were made, $317,000,000 was repaid with interest and $34,000,000 is still outstanding.

Because of the narrow margin of safety afforded by the rate increases, the committee of railway presidents requested the Railway Labor Executives Association to consider a temporary reduction in wages to employes of 10 per cent. The suggestion was rejected, but a meeting of some 1,500 general chairmen of railroad unions in Chicago a short time later expressed a willingness to have their representatives meet with a committee of the companies that would be authorized to negotiate a settlement to a conclusion. These negotiations are now in process. The railroads have also filed with the Railway Labor Board a formal application asking for a 15 per cent reduction in wages, in accordance with the procedure specified by law.

It is estimated that a 10 per cent reduction in wages would mean a saving to the railroad companies of approximately $200,000,000. Even this step cannot guarantee the workers continued employment, but it will protect their interest in the solvency of the country's financial institutions, for in the event of further continued decline in security prices and additional receiverships they would suffer the grave consequences along with the general public.

"No Dole for Idle Capital"

Although the representatives of the railroad companies and the unions have not yet come to an agreement on a mutual policy, they have displayed a commendable will to cooperate. Mr. Daniel Willard, chairman of the committee for the railroads, stated that "the conferences had been carried on in a fine spirit of friendship and that the discussions had been wholly devoid of any unpleasantness." At the same time, some of the spokesmen for labor appear to reflect a feeling that labor is being asked to make sacrifices which are unfair and out of proportion to those being made by capital. Following are two paragraphs quoted from the letter of Mr. D. B. Robertson, Chairman of the Labor Executives, rejecting the proposal and explaining the attitude of labor on this point:

> In behalf of the interests which you represent (in a word to protect and to increase the present wages of capital) you have suggested that we recommend that all railway employees offer to take a voluntary reduction of 10 per cent in the payrolls based on present wage rates. This suggestion has not been coupled with any assurance that the money thus saved would be applied either to increase employment, or even to stabilize existing employment. We cannot regard seriously the argument that employment would be increased by such a wage cut, when those who make the argument decline positively to give any assurance that even men now employed will be continued in employment for any definite period.
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> More than one-third of the employees of this industry are idle and more than one-third of the capital in this industry is idle. You are taking nothing from the earnings of capital to support unemployed workers. You are asking that the employed workers take 10 per cent from their earnings to support idle capital. We submit that the first duty of the employed workers, after their duty to their dependents, is an obligation to their fellow employees who are denied an opportunity of employment.

The principle that has been here raised is of fundamental importance and deserves the most careful examination. Is it true that the wages of capital have taken no cut as a result of the depression and, for that matter, who are the beneficiaries of the rights of capital referred to?

Widespread Ownership of Securities

On its face, the plea that human rights should come ahead of rights of capital seems to appeal to an ethical sentiment. However, the holders of securities also are human, and the idea that the railroads are controlled by a limited number of "capitalists" has long ago been disproved. Last year the Committee on Interstate and Foreign Commerce, House of Representatives, submitted and published a report entitled "Regulation of Stock Ownership of Railroads," that contains the most complete data ever assembled on the subject of railroad ownership.

According to this report, the 160 Class I railroads in the United States with a gross capitalization of $23,000,000,000 had over 840,000 names on their stock registry books on December 31, 1929.

In the case of the Pennsylvania Railroad, with 196,119 shareholders of record on December 31, 1929 (which number had increased to 243,361 on December 1, 1931) the largest individual shareholder held only 34/100 of one per cent of the total stock and the thirty largest shareholders of record held only 4.56 per cent.

With some roads the portion of stock held by the thirty largest holders runs up to 25 per cent or higher, but this is due in most cases to the fact that a substantial investment in the stock is held by some other railroad and the fact that literally hundreds and in some cases thousands of individual accounts are represented by names of brokers, banks and nominees included among the thirty largest holders as shown on the railroads' books. The corresponding percentages of stock in the names of the thirty largest holders were, for the New York Central 22.57, (of which the Union Pacific Railroad owned 5.35 per cent), Baltimore & Ohio 16.20, Southern Pacific 15.10, Atchison, Topeka & Santa Fe 13.04 and Union Pacific 16.98. These six leading companies alone had approximately 32,000,000 shares outstanding, of which about 3,900,000 were registered in the names of the thirty largest holders of each company, the balance being distributed among 460,000 investors with an average holding of only 60 shares.

As to the tradition of personal control of railroads, the Parker Report contains the following interesting comment:

> At one time it was customary to speak of certain roads as Morgan, Hill, Harriman, Gould, or other properties. In considerable part such designations rested on personal ownership, at least in the case of such of these men as identified themselves solely with transportation enterprises. The tradition that certain men "own" our railroads continues down to date, despite the fact that even in the early days personal ownership required supplementation from other sources to be effective and despite the fact that, barring a few exceptional cases, a vast diffusion of ownership has occurred in the course of the past two or three decades. The emphasis has perhaps shifted a little at this time, the thought now being that the financial houses headed by the great names in modern finance own vast amounts of railroad securities. Taken literally and even somewhat broadly, such a view does not accord with the ascertainable facts.

Dividend Cuts in 1931

Common stocks of forty-six important railroads are listed on the New York Stock Exchange, of which thirty-one were paying dividends at the beginning of 1931. Of this number, only six were able to maintain the same rate of dividend during the year, including the Atchison, Topeka & Sante Fe; Bangor & Aroostook; Chesapeake & Ohio; Delaware & Hudson; Norfolk & Western; and Union Pacific.

The 182,073 shareholders of seventeen railroads had a 100 per cent cut in their rate of income from these sources some time during the last year when dividends were omitted entirely, as shown by the following list giving the rate prevailing at the beginning of the year:

Company	Rate 1-1-31	Shareholders 12-31-29
Baltimore & Ohio	$7	34,733
Boston & Maine	4	2,659
Chicago & North Western	4	14,448
Chicago, Rock Island & Pac.	7	5,243
Colorado & Southern	3	479
Illinois Central	7	14,994
Kansas City Southern	5	858
Lehigh Valley (b)	4½(a)	6,291
Missouri-Kansas-Texas (c)	3	2,768
New York Central	8	54,122
New York, Chicago & St. L.	6	1,636
New York, New Haven & H.	6	19,002
Pere Marquette	8(a)	1,759
Pittsburgh & West Va.	6	515
St. Louis-San Francisco	8	8,931
Southern Railway	8	13,139
Texas & Pacific	5	496

(a) Partly extra. (b) Par value $50. (c) No par value.

In addition, 354,945 shareholders of eight other railroads had their rate of dividends reduced as follows:

Company	Reduction 1931	Shareholders 12-31-29
Atlantic Coast Line	$10(a) to $4	4,479
Dela., Lacka. & West. (c)	7(a) " 2	6,943
Great Northern, Pfd. (b)	5 " 2	42,085
Louisville & Nashville	7 " 4	6,490
Northern Pacific	5 " 3	38,359
Pennsylvania (c)	4 " 2	196,119
Reading Co. (c)	4 " 2	4,682
Southern Pacific	6 " 4	55,788

(a) Partly extra. (b) No common outstanding.
(c) Par value $50.

Of the thirty-one common stocks paying dividends at the beginning of 1931 the average rate was $7.26 per $100 share, while the average at the end of the year was $2.81 representing a cut in income to shareholders of 61 per cent.

Many of these omissions broke a continuous record of dividend payments extending back for a long period, in some cases fifty years or more, including such roads as the New York Central, Chicago & North Western and the Illinois Central.

In addition, a number of preferred dividends were discontinued in 1931 after a continuous record extending back many years, including:

Chicago & North Western 7% Pfd.
Chicago, Rock Island & Pac. 7% Pfd. and 6% Pfd.
Erie 4% 1st Pfd. and 4% 2nd Pfd.
Gulf, Mobile & Northern 6% Pfd.
Missouri-Kansas-Texas 7% Pfd.
Missouri Pacific 5% Pfd.
N. Y., Chicago & St. L. 6% Pfd.
Pere Marquette 5% Prior Pfd. and 5% Pfd.
Southern Railway 5% Pfd.
Wabash Railway 5% Pfd.

Aside from the sacrifice in income last year, railroad shareholders suffered a severe decline in the market value of their investments, in

some cases amounting to a virtual collapse. Aggregate common stock of the forty-six listed companies amounted to $5,673,000,000 par value, and at the 1931 high quotations, reached in most cases during February, the aggregate market value was approximately $4,600,000,000, whereas at the 1931 low quotations in December the market value was but $1,100,000,000, representing a shrinkage of $3,500,000,000 or 76 per cent. Expressed on a per share basis, the average price declined from $81 to $19; in other words, capital in the railroad industry sold down to 19 cents on the dollar investment at par, not counting in the corporate surplus.

Someone Must Supply the Capital

There is a fundamental fallacy in the disregard of investors' interests that should be clearly apparent, for if it were not for the investment of capital there would be no railroad system providing employment and a livelihood for more than one million railway employes and their families. Our whole economic civilization is advanced by the saving and accumulation of capital, while the progress of any industry ceases if its supply of new capital be cut off.

All of the basic industries are dependent upon the railroads for securing their raw materials and shipping their finished products. It is true that motor trucks have taken a substantial volume of the traffic in general merchandise, some of which is the most profitable class of business, away from the railroads but there seems no reason to seriously question the place that the railroads will hold indefinitely in the transportation of bulky commodities. In its recent decision on the rate case, the Commission remarked that, "The railroads now furnish the backbone and most of the other vital bones of the transportation system of the country, and we believe this will be the situation for a long time to come".

To handle all freight by truck would be a physical impossibility in view of the already overcrowded condition of the highways. For example, one train of coal with a crew of five men is able to do the work of 1000 five-ton trucks operated by 1000 drivers. Similar illustrations could be given with regard to movement of lumber, ore, metal products, livestock, grain and other heavy traffic. Services of the motor trucks, air transports, waterways and pipe lines will probably never displace that of the railways, but should be coordinated and regulated so as to maintain fair conditions of competition.

The permanent health of the railroad industry depends upon its ability to secure several hundred million dollars of capital each year for refunding purposes, extension of lines, equipment, terminal facilities, etc. Someone must supply the new capital, but it cannot be attracted unless there is confidence on the part of investors that it will be safe and will earn a reasonable return.

Other Constructive Measures Proposed

The recently published annual report of the Commission indicates a constructive attitude on the part of its members when it recommends the repeal of the ineffective "recapture clause" and the substitution of a modified rule of rate regulation, as follows:

> Recognizing that because railroad earnings will inevitably fall below the standard level in times of business depression they may properly be permitted to rise above it in times of prosperity, and stressing the need for maintaining an adequate national transportation system and the consequent need for maintaining railroad credit; and substitute a stable rate base which may be kept current by accounting methods for a base reflecting what is termed fair value of carrier property for rate-making purposes.

Other important recommendations of the Commission are that its powers for regulation be extended to motor, water and air carriers, freight-forwarding companies, refrigerator-car companies, electric railways interested in interstate business and holding companies controlling railroads through ownership of stock.

Relief should be given from the heavy nonproductive expenditures for grade-crossing elimination, etc. Expenditures for improvements and additions to roadway and structures by all railroads were $544,000,000 in 1930 and $3,877,000,000 during the past eight years 1923-1930. In the case of the New York Central Railroad, the elevation of its west side tracks, including terminals, in New York City will cost in excess of $150,000,000. Moreover, railroad tax assessments have become unreasonable and almost unbearable.

Lastly, there are, no doubt, numerous steps that the railroads themselves can take in improving their condition, among which might be suggested the further reduction of the excessive number of high-speed luxury passenger trains, elimination of uneconomic competition between themselves for traffic through rate-cutting and abandonment of many unprofitable services. In this connection the Commission stated in its recent decision on the rate case that the passenger service as a whole fails by something like $450,000,000 annually to contribute its proportional share toward taxes and return on railroad property.

The Foreign Debt Moratorium

The situation regarding the moratorium upon foreign government debts owing to the Government of the United States has been involved in some confusion by the fact that it was impracticable to obtain action by the Congress, ratifying President Hoover's pro-

posal of last June, before December 15, the date at which a number of the foreign payments were due. It being apparent that action would not be had before the 15th the debtor governments having payments due on that day would be technically in default, and the question arose as to what might be properly done to relieve them of this embarrassment. It was agreed by the Treasury and State Departments, that in answer to inquiries that might be made by governments concerned an informal statement would be made, explaining the inability of the Congress to act upon the matter within the time limit, and that under the circumstances, while neither the President nor any of the executive departments had power to alter the terms of the debt agreements, this government held the view that a postponement of the December 15 payment "should not be subject to any just criticism."

The agreement was ratified by the House on December 18 by a vote of 318 to 100 and by the Senate on December 22 by a vote of 79 to 15. A resolution was attached declaring opposition to any further cancellation or revision of the debts owing the United States.

Proposal for Further Examination of Debts

This resolution is not necessarily the last word on the subject, for it can be repealed by a subsequent resolution. Its passage probably was intended as a response to the President's message on foreign affairs, in which he proposed the re-creation of the World War Foreign Debt Commission, for the purpose of making a re-examination of the settlements heretofore made, in view of present economic conditions. He supports the proposal by saying that "as we approach the new year it is clear that a number of the governments indebted to us will be unable to make further payments to us in full, pending recovery in their economic life."

Secretary Mellon followed the President with a statement of greater detail supporting the proposal for the re-creation of the Debt Commission to consider the ability of the debtor countries to pay under existing conditions. Neither the President nor the Secretary made any plea for a permanent reduction of existing obligations, their arguments being confined to the need for a lenient policy during the existing depression, as an aid to general business recovery.

Secretary Mellon referred to the great difficulties in which the finances of Austria and Hungary are involved, but laid special stress upon the increased burden of debt payments by Great Britain while her currency is depreciated as at present. The circumstances under which Britain was obliged to suspend gold payments are familiar. It was due to the stress of world conditions and in part to the efforts of London to give aid to central Europe and thus stop the spread of panicky conditions. By way of illustration the Secretary said:

> Payments due during the present fiscal year will serve to exemplify the magnitude of the additional burden. With the pound sterling at par, the British Treasury needs £32,800,000 in order to pay us $159,-500,000. With the pound sterling at the rate at which it sold on Dec. 10, 1931, it would take £48,100,000, or an increase of £15,300,000, or 47 per cent. Or, in other words, the burden on the British taxpayer is increased by one-half.

Great Britain was the first country to make a settlement of the war debts, and on the basis of ability to pay as then reckoned did so on a much higher basis than any other country. Her ability to pay has changed as shown by the above calculation. This may be a temporary situation, for when the world finds prosperity again Great Britain will quite surely find it also. These are extraordinary times and to insist upon a continuance of full payments under present conditions would be to impose hardships upon a friendly nation which it may be assumed few of our people would want to inflict if they understood the situation.

There is another view also which may be taken. Secretary Mellon mentions that Great Britain last year imported $678,000,000 of our agricultural and industrial products. Under the pressure of foreign competition in her home market and hostile tariffs in foreign markets she is changing her tariff policy for the avowed purpose of securing more liberal treatment for her own goods abroad. Furthermore, her dominions, which are the chief competitors of this country as producers of farm products, are pressing her hard for preferences in her great market. If the will to reduce her purchases of our products should exist, the opportunity and excuse probably could be found.

This, however, is not the reason which should govern this country's action. We will act in our own interest, if we act in the general interest and follow the policy which will remove an evident obstacle to the return of normal business conditions the world over.

Reparations and Debts

Whether or not we admit the contention that reparations and debts are tied together they have certain effects in common. The transfer of great sums of money from one country to another is not an ordinary incident of business relations, but an unusual and disturbing event. The normal character of international relations is that of exchanges in which both sides find a profit, and money—gold—is used only for convenience in the settlement of net balances, like Clearing House balances, running first one way and then the other. The panic of 1907 in this country, which sent money to very high rates and caused an emer-

gency movement of produce and securities to European markets in exchange for cash, resulted in net gold imports of only about $100,000,000, but caused a pronounced rise of interest rates all over Europe. The indemnity which France paid to Germany following the war of 1870-71, while nominally paid in gold, actually involved the transfer of comparatively little gold. The French people were holders of large amounts of foreign securities, which were saleable in foreign markets, and the French Government offered its own bonds for sale in the domestic market upon terms which induced an exchange of the foreign holdings therefor. The latter were sold abroad, the transaction being spread over several years, and the credits thus acquired were transferred to Germany, with precautions against disturbing the markets.

Whenever the character of international relations is changed from that of exchanges which offset and settle themselves to a continuation of one way balances which must be settled in gold (or whatever the international medium might be) the credit situation is disturbed in a manner harmful to all business.

The explanation is that gold, the money of international payments, for that very reason is the money of bank reserves in all countries, and the basis of credits to many times the amount of the reserves. This is the banking practice of the world, designed to economize gold, and a perfectly safe practice so long as the exchanges practically settle themselves, as they usually did before the war, but abnormal drafts upon these reserves vitally affect the credit situation in the countries making the payments.

Continuing Balances Calling for Gold

If reparations and the government debts were payable in the products of debtor countries, the payments might be accomplished, but the creditor countries themselves are unwilling to receive payments in this manner. The reparations creditors do not want German goods and the United States does not want goods from its debtors. The result in both cases is continuing balances calling for gold, in amounts which deplete the reserves of the debtor countries and hamper the ability of their banking systems to supply the credit required to sustain a normal level of prices.

If credit conditions were such as to enable the debtor countries to borrow abroad the sums they were required to pay, the account could be balanced temporarily in this manner, and indeed, Germany paid reparations in this way for several years, but it has proved to be an uncertain resource.

It may be said that during the years when the United States in the aggregate was largely indebted to Europe the latter was under no agreement to take payment in products. The essential fact, however, is that payments were balanced with relatively small shipments of gold, and this is a necessary condition if business is to be conducted on the gold basis.

The trouble is that from the beginning of the reparations and debts controversy the creditor countries have failed to recognize that as between nations accounts must approximately settle themselves without money payments. Even in domestic business ninety per cent or more is settled by the clearing process, and this method is still more important in international business, where payments in gold affect exchange charges, prices and credit conditions.

It is true that there are other items in the international account which may be adjusted to allow for reparations or debt payments, but unfortunately they do not adjust as readily as exchange rates, and therefore do not relieve the pressure for gold shipments. Trade should settle itself and debts should be settled through trade, and this is what naturally occurs, except in the case of political debts, which are made without regard to trade.

The debtor countries have wealth, some of them great wealth, in the form of lands, houses, railroads, factories, mines, etc., but these forms of wealth cannot be transferred out of the country. Only the products of these properties can be used to create credits in foreign countries, and against these almost insuperable obstacles are now raised.

The Moratorium Year Passing

One-half of the moratorium year on reparations and government debts has passed, and little progress apparently has been made toward an agreement upon what will be done when the year is up. There seems to be little more comprehension of the problem involved in these payments than there was six months ago. The sincerity of those who insist upon payment according to the letter of the bond, notwithstanding the changed conditions, need not be questioned, but their minds are fixed upon a routine system of money payments which has little to do with the international situation.

The first step of the Dawes Plan was to provide a gold basis for Germany by means of a loan subscribed in the main by her creditors. This was to furnish the base of an internal currency, enable her industries and trade to function and thus pay reparations. Of course, this reserve was not intended for the payment of reparations. The reserve has been higher, as the result of other foreign loans, made in the belief that the reparations plan was working successfully, but now has been reduced to but little more than the original amount.

The German loans that were made in this country were distributed to the public in good faith. Practically none of the proceeds went to Germany but were disbursed here either for purchases of American products or for reparations payments. The amount of foreign loans contracted by Germany since the Dawes Plan went into effect has been greater than the reparations payments, which is justification for the statement that but for the loans reparations payments could not have been made.

Until there is a change in present conditions it is evident that no more German bonds will be sold in foreign markets, hence such sales are not to be considered as a source either of reparations or of debt payments to the United States.

Influence on Business

It cannot be doubted that reparations and government debts have become the most depressing influence upon the business situation. The conditions in Germany afford little reason to believe that the Treasury will have any funds with which to pay reparations or that any government which attempts to pay reparations in the present state of the country will survive an election. We shall not undertake to say what nations will or will not make payments to the United States in case they receive none from Germany, but hold the opinion that all of the allied countries should, in such adjustments as are found necessary, bear their portion of the burden; and that this country will gain by an attitude of reasonable cooperation and compromise in a time of such universal distress.

It is in order also to say that the sums involved in the annual payments on these debts are small for the countries that are involved in comparison with the cost of present economic conditions. The total payment to the United States of about $250,000,000 a year is a truly insignificant figure in comparison with the shrinkage in the earnings of the industries of this country or the wage losses of the workers, or even the sums raised for unemployment relief.

The supreme question of the time is not whether the debts shall be collected or not collected, but how this country may cooperate with other countries in restoring industry and normal living conditions for the American people.

Great Britain's Protective Tariff

The action of Great Britain, one of the chief markets and heretofore an open market to all trade, in changing to a new policy based upon protection to home industries must be regarded a matter of grave concern in this time of general depression. It may add very much to the existing trade confusion. It will not be denied that Great Britain has as much right to make the terms upon which foreign goods may enter her markets as have the other countries which have preceded her with similar policies operating to her disadvantage. The arguments which finally have carried the day in Great Britain have included all the arguments for tariffs used elsewhere, with another which probably has counted for more than all the rest, to wit: that Great Britain was unfairly treated in having barriers raised against her products everywhere while her own market was an open dumping ground for everybody. The plea was made that she must have means of defence and bargaining power.

The protective policy has been the common policy among nations, but in recent years has been carried to extremes not reached before. It always has been popular in new countries, ambitious for rapid growth in population and industry, as evidenced by the unwillingness of the British dominions to accept the mother country's doctrine. In Europe the importance of economic self-sufficiency in the event of war has been one reason for tariff-making. Protection against low wage competition has been a leading consideration in high wage countries, such as the United States, Canada and Australia, but there is reason to believe that in many instances it would have been better policy to allow the low-wage countries to supply the limited variety of goods which they have to offer, in exchange for goods more advantageously produced by highly paid labor. This country has had in years past a profitable foreign trade through exports of automobiles, farm machinery, farm products, and a large variety of goods which were sold in both low-wage and high-wage countries because they were suited to the markets, and import tariffs, if any, were moderate. It cannot be disputed that industries which thus are able not only to command the home market but to send their products into all parts of the world have larger opportunities for growth and expansion than industries that have a less sure footing. It is questionable policy to sacrifice the strongest industries in efforts to build up weaker ones, but this is what we have done in many instances and other countries have done likewise.

Advantages of Trade

In short, in the eagerness of all countries to multiply industries to supply all their own wants there is danger of overlooking the advantages of trade. Each may have a greater variety of products, but greater efforts are required to produce them. Every people, by reason of conditions peculiar to itself, is able to do certain kinds of work more advantageously than others, and these are the kinds which it should do. When the work of the

world is done on this basis the highest possible state of general prosperity and welfare will be attained. Specialization and the division of labor form the basis for mutually profitable trade. All internal business is on this basis, and the larger the area of trade the more marked are the advantages of the system. The United States has an acknowledged superiority in this respect over the countries of Europe.

This is not saying that all tariffs, judged by themselves, have been unprofitable to the countries adopting them, but they are seldom helpful to a domestic industry without being harmful elsewhere, and the network of them has become so complicated that undoubtedly it is an embarrassment to general trade.

Mr. James D. Mooney, Vice President of the General Motors Corporation, returning from Europe last month gave an interview to the press in which he spoke very emphatically upon the situation. He said, in part:

> This movement toward commercial isolation, which began about two years ago, has attained an amazing acceleration during recent months.
>
> In all of the countries I visited in Europe—England, France, Germany, Denmark and Sweden— industrial, commercial and financial leaders everywhere are appalled at the destructive effects on credit and confidence, caused through the breakdown in the movement of goods, precipitated by these tariffs.
>
> During the past two years of depression, the various nations throughout the world have become armed to the teeth with tariffs and other restrictions to imports in normal trade. Everybody seems to be going on the theory that it is good business to sell but not to buy; to ship goods without taking other goods in exchange for them.

In the last paragraph Mr. Mooney has touched upon the fundamental fallacy which has brought about the present situation, to wit: the idea that it is "good business to sell goods but not to buy." This theory has brought the world almost to an impasse as far as international trade is concerned, for the proposition is an impossible one. Trade of necessity is what the word signifies, an exchange of goods and services.

The people who believe that mutual gains are to be had in trade have hoped that gradually, with the growth of international intercourse, trade restrictions would be lessened, but the war has been responsible for a trend in the other direction, and the depression has emphasized it. The volume of trade has undergone such a shrinkage and trade balances have assumed such immediate importance that attention has been concentrated more than ever upon home markets. In other words, each country has given more attention to suppressing imports than to extending its own sales, because the former policy has seemed the more certain to yield results. The result of this universal policy undoubtedly has been to reduce the aggregate of consumption and trade, whereas if the volume of the exchanges could be enlarged it would be to the general advantage.

Great Britain has felt the pressure of imports upon her home industries and resented the obstructions raised to her trade in foreign markets. From her standpoint she may consider herself justified in adopting all the methods of trade warfare, but it remains to be seen whether trade warfare, even if she has a part in it, will improve her trade position. The whole world has fallen into the error of regarding trade as warfare between nations and adapting national policies to that theory. This comes from laying all the emphasis upon selling instead of upon mutually profitable exchanges.

Mutually Harmful Rivalries

It is evident that trade has been greatly complicated by the idea of rivalry between nations instead of between traders. There is competition between individuals of the same country and also between individuals of different countries, but such competition will settle itself if left to do so. No one nation has all the advantages or all the good traders or can do all the business that is to be done. Left to itself trade will confine itself to mutually profitable business but under the direction of governments numerous practices have been adopted that clearly are injurious to all parties concerned. The fostering of industries by means of bounties, of which the sugar industry has furnished many examples, has been a factor in overdoing world production, but has only done in one way what a tariff or other species of legislation may do in another, the result in each case being that production has been unwisely stimulated. Only recently India, which has been a market for the Java product, has established a new duty which will force Java to market more of her crop in Europe. However, no more extraordinary example of sugar policy can be named than that of the United States in developing an industry in the Philippine Islands to supply the wants of this country, to the exclusion of the product of Cuba, situated almost within sight of our shore.

A bounty upon exports of coal carries the product of Poland into markets that naturally would be supplied by other countries and the coal industry of Great Britain has been organized by recent legislation so that lower prices may be made for export than for the home market. This is a game in which any country may play, and when play becomes general demoralization becomes complete. Fortunately anti-dumping laws have placed a check upon it.

Wheat is a staple commodity subject to heavy import duties in Europe, notably in Ger-

many and France. Great Britain is about to establish a consumption quota for home grown wheat, to be bought at an artificial price, another mischievous precedent.

When Great Britain recently suspended gold payments, thereby depreciating its currency, it was thought at first that a definite stimulus had been given to foreign trade. Among other apparent gains British coal was able to enter France in competition with French coal, but France promptly nullified this gain by increasing the import duty. The cheapening of the currency also seemed likely to help British cotton goods in China against the Japanese product, but the suspension of gold payments by Japan places the currency of that country in the same state of confusion. The two currencies are not on an equality; they have lost their connecting link, and to the disadvantage of both no longer have fixed relations to each other.

These are examples of recent legislation affecting trade injuriously for all parties. It is currently stated that fourteen nations of Europe have altered their tariffs since Great Britain left the gold standard. The Dutch member of the international committee which is examining the ability of Germany to pay the full reparations under the Young Plan, has publicly expressed the opinion that German exports to pay reparations have been responsible for many of the tariff advances of recent years. This view is supported by the action of Switzerland within the past month in giving notice of further advances to stop the increasing imports of German goods to the disadvantage of Swiss products. The reparations exports probably have intensified the tariff situation, but it has been growing worse under its own provocations, until it would seem that there might be general agreement upon the need for a more cooperative policy in world trade.

Relations of Britain and Denmark

One of the avowed objects of the new British legislation is to correct the trade balance, in other words reduce the proportion of imports to exports. The Daily Mail, of London, in its advocacy of the tariff, has made an example of the relations of Denmark with Britain, as follows:

> Our Government might, for example, approach Denmark and warn her that if she cannot give us special advantages for the sale of our manufactured goods in her territory, we shall not be able to allow the importation of immense quantities of her bacon and butter into Britain. Last year the Danish imports into Britain were valued at £54,000,000 (approximately $250,000,000). The British exports to Denmark were valued at only £10,248,000 (approximately $50,000,000).

Denmark has built up the sale of her agricultural products in England by long and careful attention to the wants of that market, and of course there could be no valid objection to a growth of English production by the same methods. Such a change could hardly occur except gradually, but the suggestion of hostile legislation against such long-established trade is alarming. It may be that to some extent Denmark could meet the suggested condition of buying more from England, but the fact that she has not done so voluntarily indicates that England is not in position to supply what is wanted, at least on equal terms.

It is fair to presume that when the tariff rates are made consideration will be given to long standing relations. Nevertheless, the objects in view, to wit: correcting the trade balance and giving a preference within the empire, cannot be accomplished without disturbance.

The trade relations of Great Britain are wider than those of any other country and if all are affected, as presumably they must be, the disturbance will be widespread. Moreover, the fact that the British currency now is subject to wide fluctuations is another confusing factor.

It must be admitted that the responsibility for beginning tariff warfare does not rest upon Great Britain, but that is not the important question now. No country can gain by the state of confusion in trade relations that now exists, and it is in the way of becoming worse. While there is no reason to look for a sweeping reform in world tariffs, possibly improvement may begin by regional agreements. Already there are negotiations for a tariff union between France, Belgium, Holland and the Scandinavian countries. If something practical comes out of this it may spread in Europe and lead to further developments.

First Tariff Act

The first British tariff act is in the form of a resolution, which authorizes the Board of Trade, a government office, to impose duties up to 100 per cent ad valorem upon manufactures. The reason given for this sweeping revolution was that large imports were being rushed into the country in anticipation of a general tariff act. A further resolution has been passed authorizing duties on fresh fruits, vegetables and garden products, which has given concern to the cross-channel countries that have sent many of these products to English markets.

American exports of manufactures to Great Britain are not large in comparison with the exports of food products and raw materials, but they are not inconsiderable and of course will be affected.